INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	1
Statutes involved	2
Statement	2
Argument	5
Conclusion	8

CITATIONS

Cases:

Automobile Club v. *Commissioner*, 353 U.S. 180 — 7

Better Business Bureau v. *United States*, 326 U.S. 279 — 5

Birmingham Business College, Inc. v. *Commissioner*, 276 F. 2d 476 — 7

Commissioner v. *Lane-Wells Co.*, 321 U.S. 219 — 8

Erie Endowment v. *United States*, 316 F. 2d 151 — 6

Kenner v. *Commissioner*, 318 F. 2d 632 — 7

Statutes:

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

Sec. 101(6) — 2, 5

Sec. 291(a) — 7

Sec. 3814(1) — 6

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

Sec. 501(c) — 5

Sec. 504(a) — 6

Sec. 7805(b) — 7

Miscellaneous:

H. Rep. No. 2319, 81st Cong., 2d Sess., p. 40 — 6

735-108—64

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 830

STEVENS BROS. FOUNDATION, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHT CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. A1–A71) is reported at 39 T.C. 93. The opinion of the court of appeals (Pet. A73–A101) is reported at 324 F. 2d 633.

JURISDICTION

The judgment of the court of appeals was entered on November 15, 1963 (Pet. A102–A103). The petition for a writ of certiorari was filed on February 13, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the taxpayer was properly denied exempt status for the period 1948 through 1955 because

it was not operated exclusively for charitable purposes, as required by Sections 101(6) of the 1939 Code and 501(c)(3) of the 1954 Code.

2. Whether the taxpayer was properly denied exempt status for the period 1952 through 1958 pursuant to Sections 3814 of the 1939 Code and 504 of the 1954 Code because its accumulation of earnings was unreasonable in amount and duration.

3. Whether the Commissioner abused his discretion in retroactively revoking his 1947 ruling that the taxpayer was exempt from income tax as a charitable organization.

4. Whether the taxpayer had reasonable cause for failure to file income tax returns for the years 1948 through 1954 so as not to be liable for additions to tax under Section 291(a) of the 1939 Code.

STATUTES INVOLVED

Sections 101(6), 291(a), 3791(b), and 3814 of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.) and Sections 501 (a) and (c), 504(a) and 7805(b) of the Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.) are set forth in the appendix to the petition (Pet. A104–A116).

STATEMENT

Taxpayer was incorporated under the laws of Delaware on December 31, 1942, by Edward Fenton Stevens, his wife, and two of his brothers, and maintains its principal office in St. Paul, Minnesota. On May 1, 1947, the Commissioner of Internal Revenue issued a ruling that taxpayer was exempt from federal income taxes as a charitable corporation under Section 101(6) of the 1939 Code, subject to redetermination if it

changed its character, purpose or method of operation (Pet. A74–A75).

The four persons who incorporated the taxpayer were also members of a partnership known as Stevens Bros. Contractors. During the years here involved, the partnership owned two-thirds of the stock, and Stevens was president, of a construction company known as Stevens Bros. & Miller-Hutchinson Company, Inc. (Pet. A75). During the period 1947 through 1954, the taxpayer entered into a series of construction joint ventures with the corporation (Pet. A12–A15, A75–A77). Both courts below concluded that a major purpose of taxpayer's involvement in the construction projects was to benefit its founders through their interest in and indirect control over the corporation (Pet. A15, A81, A81).

Sometime in 1947 or 1948, Stevens secured a patent for a therapeutic heating device on behalf of the taxpayer. The costs of developing and manufacturing the heaters were incurred by the partnership and treated as a gift by it to the taxpayer. About 100 heaters, worth approximately $4,510.25, were distributed free of charge by the taxpayer to individuals, hospitals, and old folks' homes (Pet. A77).

Taxpayer began making educational loans to college students about 1952. Repayment was waived in the case of most or all of the 32 loans, totalling $4,605, made during the taxable years 1953 through 1955. For its taxable years 1956 through 1958, taxpayer made 36 loans, totalling $7,496, which are extended without question when a student advances a good reason for delay in payment (Pet. A77).

Taxpayer's books indicate receipts, disbursements and student loans as follows (Pet. A77–A78):

Fiscal year through—	Contributions received and other income	Expenses	Contributions, gifts, grants, etc.	Student loans	Surplus balance
1947	$106,611.75	$139.87	$4,227.50		$101,244.38
1948	87,810.98	27.00	1,245.25		187,783.11
1949	35,024.83	12,315.75	235.00		203,267.19
1950	181,471.85	24,713.33	1,825.00		358,188.71
1951	94,967.41	19,237.00	1,000.00		432,919.12
1952	73,782.91	19,230.00	250.00		486,222.03
1953	38,317.89	19,295.00	2,000.00		503,154.92
1954	19,741.79	9,630.00	3,991.64		509,335.07
1955	20,680.41	1,450.00	2,915.00		526,550.48
1956	14,331.00	1,392.20	2,150.00	$779.00	537,339.28
1957	24,278.26	3,571.00	1,600.00	1,725.00	556,446.54
1958	49,014.52	2,050.55	1,725.00	5,001.00	601,685.51
Total	745,033.60	120,053.70	23,294.39	[1] 7,496.00	

[1] The listing of the student loans as having been made during the years 1947–1949 in the court of appeals' opinion (Pet. A78) is a typographical error (see Pet. A18).

On or before August 20, 1953, taxpayer's members planned to have the taxpayer accumulate $1,000,000 from which they calculated taxpayer could derive an annual income of $50,000. They expected this to be sufficient to meet the taxpayer's expenses and have a significant sum available for charitable purposes (Pet. A78).

By letter dated August 24, 1954, the Commissioner notified the taxpayer that its tax-exemption ruling was revoked because it had not been operated exclusively for charitable purposes and because it had spent only a nominal amount of its substantial income for purposes upon which its tax-exempt status was based (Pet. A20).

ARGUMENT

The decision below is correct. There is no conflict of decisions or any other basis for further review by this Court.

1. To qualify for income tax exemption under Section 101(6) of the 1939 Code (Pet. A112) or its successor, Section 501(c)(3) of the 1954 Code (Pet. A104), a corporation must be "organized and operated exclusively for * * * charitable * * * purposes". The term "exclusively" has been interpreted by this Court in a similar context to mean that a single nonexempt purpose, if substantial in nature, will defeat the claim to exemption. *Better Business Bureau* v. *United States*, 326 U.S. 279, 283.

Both courts below found that taxpayer's involvement in joint construction ventures with a corporation controlled by its founders was "to a substantial extent an effort to benefit its founders" (Pet. A15, A31, A79, A81). The Tax Court concluded that taxpayer "was not operated exclusively for tax-exempt purposes" (Pet. A31), and the court of appeals agreed, stating that the record belied any assertion that such activities were "of an incidental nature" (Pet. A82). These conclusions are supported by the undisputed facts—the manner in which taxpayer's founders benefited from its advancement of funds to a corporation which they controlled (Pet. A31), the circumstances, particularly the timing, of the advances (Pet. A30–A31), and the size of the amounts devoted by taxpayer to the construction ventures in relation to the insignificant amount of funds disbursed for charitable purposes (Pet. A18). In effect, the taxpayer was being used to finance the construction ventures.

2. Exemption from income tax is denied to any organization whose accumulations out of income are "unreasonable in amount or duration". Section 3814 (1) of the 1939 Code (Pet. A115–A116); Section 504 (a)(1) of the 1954 Code (Pet. A106–A107). The purpose of these provisions is to force exempt organizations to distribute substantial portions of current income for exempt purposes. H. Rep. No. 2319, 81st Cong., 2d Sess., p. 40. Taxpayer in the case at bar accumulated $601,685.51 during the period 1947–1958, while distributing only insignificant amounts for charitable purposes (Pet. A18). On or before August 20, 1953, those in control of taxpayer had determined to accumulate $1,000,000, which—if producing income of $50,000 per year—would permit taxpayer to meet all operating expenses and have a significant sum available for charitable purposes (Pet. A19). Nothing appears in the record, however, with respect to any "functional objective" of this accumulation in terms of specific charitable uses (Pet. A33–A34). Both courts below agreed that, on these facts, taxpayer's accumulations were unreasonable in amount and duration (Pet. A34, A82–A83). The standard applied by the courts below—the existence of a concrete or definite charitable program (Pet. A38, A84)—is in line with *Erie Endowment* v. *United States*, 316 F. 2d 151 (C.A. 3d), which is the only other appellate case in which the issue has been considered. More importantly, it is the minimum interpretation of the "unreasonable accumulations" provisions consistent with the legislative purpose behind their enactment.

3. The Commissioner of Internal Revenue has discretionary power to determine the extent, if any, to which a revenue ruling shall not be retroactive. Section 7805(b) of the 1954 Code (Pet. A111); *Automobile Club* v. *Commissioner*, 353 U.S. 180. In this case, the Commissioner revoked on August 24, 1954, a ruling which earlier (May 1, 1947) had advised taxpayer that it was exempt from income tax and that income tax returns need not be filed "* * * unless you change the character of your organization, the purposes for which you were organized or your method of operation" (Pet. A10). Both courts below found that the retroactive application of the latter ruling was justified because of changed conditions which taxpayer had not brought to the attention of the Commissioner of Internal Revenue (Pet. A27, A87–A88). That conclusion is in accord with *Birmingham Business College, Inc.* v. *Commissioner*, 276 F. 2d 476 (C.A. 5th); and *Kenner* v. *Commissioner*, 318 F. 2d 632 (C.A. 7th). Apart from the question of whether the Commissioner of Internal Revenue ever may be estopped from the retroactive revocation of a ruling his action in this case was clearly warranted.

4. Similarly, taxpayer has no basis for complaint with respect to the additions to tax imposed under Section 291(a) of the 1939 Code (Pet. A113), for failure to file income tax returns for the years 1948–1954. The only "reasonable cause" asserted by taxpayer for failure to file returns was the advice of an attorney that the May 1, 1947, ruling excused it from filing returns (Pet. A63). In view of the fact that the revenue ruling was expressly limited to taxpayer's

purposes and operations at the time of issuance, taxpayer had no reason to believe that its altered purposes and activities were similarly exempt. Moreover, the question of whether failure to file returns was due to reasonable cause and not to willful neglect is "one of fact in the first instance for the * * * [Tax Court's] determination". *Commissioner* v. *Lane-Wells Co.*, 321 U.S. 219, 225.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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